# Economic Indicators

**Prepared by the Department of Finance • March 2003**

*The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.*

*This report is also available through the Internet on the Montgomery County Web Page: http://www.montgomerycountymd.gov*

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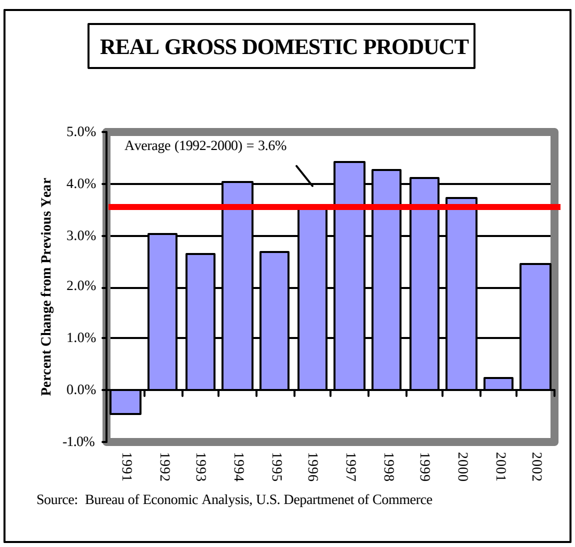
## ECONOMIC OVERVIEW

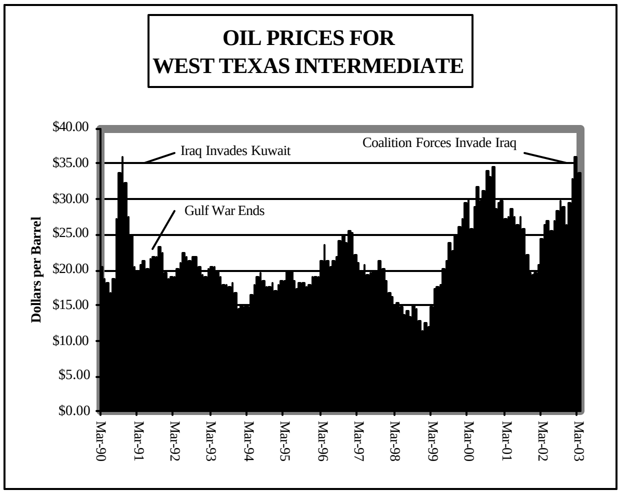
According to the most recent economic data, the U.S. economy continues to experience growth in output and income without growth in payroll employment. Real gross domestic product increased 1.4 percent during the fourth quarter of 2002 and 2.4 percent for the entire year. Such growth follows a 0.3 percent rate for 2001 in which the first three quarters experienced declines. Payroll employment remained languid during 2002 and through the first quarter of 2003. On a seasonally adjusted basis, national employment declined 262,000 since the beginning of this year and more than two million since the peak in March 2001. The stock market also remained mired in a bear market with the bellwether S&P 500 composite index declining 13.0 percent and the NASDAQ declining 21.1 percent. The bear market continued into the first quarter of 2003 with the S&P 500 declining 0.7 percent. Because of lackluster employment, the bear market, and geopolitical events, consumer confidence is at its lowest point since 1993. Consumers and businesses continue to cast doubt on a sustainable economic recovery.



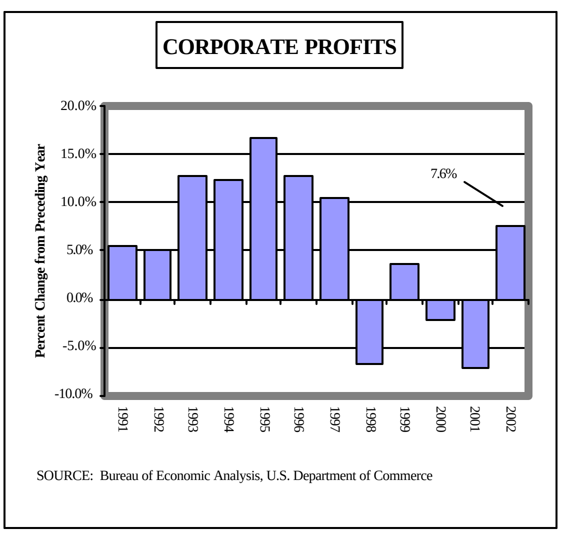

Because of continued weak consumer confidence, weak global demand, geopolitical risks, and excess capacity, business investment remained sluggish during 2002. With a strong possibility of rising fuel prices and falling trade, domestic companies tightened theirs belts rather than spending on new equipment and employees. Oil prices soared in the months prior to the war, while unemployment continued to rise.

Investment in nonresidential structures in 2002 was the lowest since 1996 and experienced the largest decline since 1991. While business spending on information technology grew in 2002, investment in transportation and industrial equipment declined for the second consecutive year. Business spending during the first two months of 2003 continued to remain sluggish with spending on nondefense capital goods excluding aircraft remaining relatively constant and nonresidential building construction increasing a modest 1.1 percent.

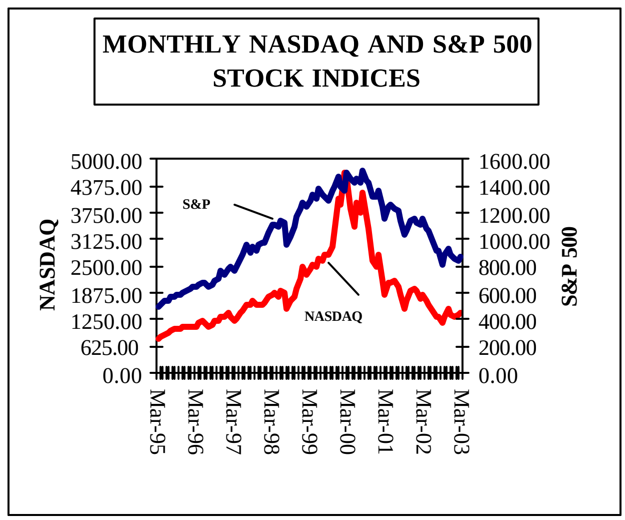
Prior to events leading up to the war with Iraq, the spot price of oil was $26.27 per barrel for West Texas Intermediate crude. Since that time, the price increased to $35.87 per barrel, or almost $10. According to *BusinessWeek*, economists gauge the economic effects of higher oil prices: for every $10 per barrel rise that lasts for a year, economic growth is reduced by about 0.5 percent and adds about 1 percent to inflation. If such an increase remains through the end of the year, inflation as measured by the consumer price index could increase from its February rate of 2.8 percent to 3.8 percent by December.




With weak economic and uncertain geopolitical factors, businesses are reluctant to begin hiring. Data from the U.S. Bureau of Economic Analysis show that while profits increased 7.5 percent in 2002 for the first time in three years, employers increased profits from productivity of existing workers rather than hiring new workers. Corporations also increased profits through other cost cutting measures such a delaying investment in new equipment rather than raising prices and expanding operations. Because of the weak current business environment, corporate earnings in the near future remain problematic.

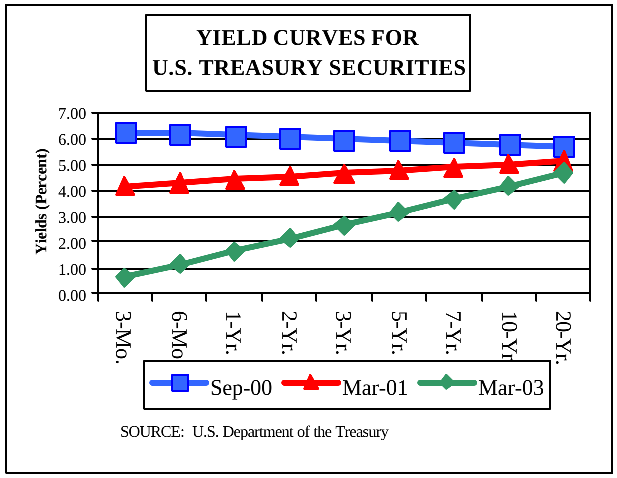



Although profits increased during 2002, the stock markets remain hampered by doubts about future corporate earnings and global uncertainty. Such uncertainty about the sustainability of profits in 2003 and beyond is a concern among investors. Stock prices are measured by discounting future cash flows or dividends. While cash flows from earnings may improve in the near term, they may be highly discounted because of the uncertainty about the strength and growth of future earnings. From December 2001 through March 2003, the S&P 500 declined 23.9 percent while the NASDAQ dropped 28.4 percent. While NASDAQ made a modest recovery during the first quarter of 2003 (+4.6%), the broader S&P 500 index essentially remained flat (-0.7%).



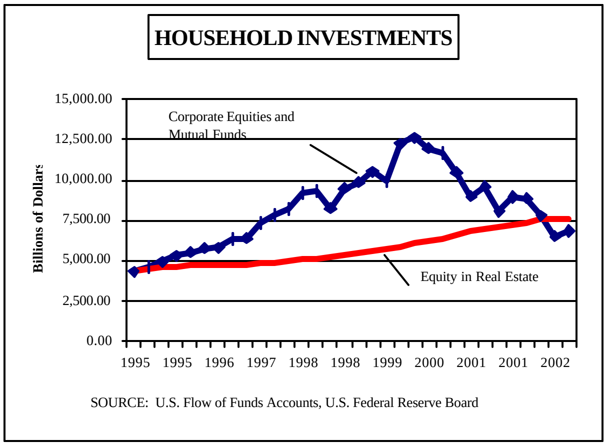

Because investor gloom continues to overhang the stock market, business spending is expected to remain weak in the short term and depress economic growth. Forecasters surveyed by the Federal Reserve Bank of Philadelphia expect the U.S. economy to grow at a meager 2.2 percent during the first quarter of 2003 and 2.5 percent for the year. A survey conducted in March by the National Association for Business Economics found that of the 223 economists surveyed, 40 percent cited war and domestic security as the main threats to the economy, up from 3 percent in August 2002. Such pessimism is due to the fact that the economic growth during the current recovery and expansion periods is below historical averages. Of the four economic variables that the National Bureau of Economic Research uses to measure economic performance, none to date has outperformed the average percentage changes observed following the previous five recessions.

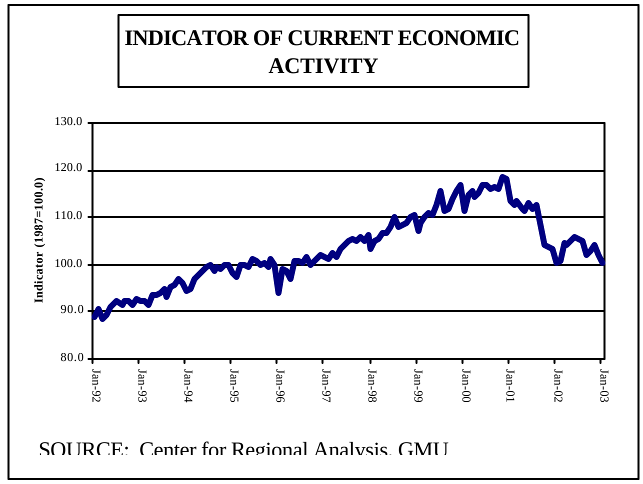
However, while the stock market and business investment remained sluggish during 2002 and the first quarter of 2003, the pessimistic outlook may be offset by an accommodative policy of the Federal Reserve and the stimulative fiscal policy of the federal government. An indicator of future economic activity is the slope of the term structure of interest rates or yield curve. The yield curve represents a spectrum of interest rates for different U.S. Treasury securities. Historical experience shows that prior to the last six recessions, long-term interest rates dipped below prevailing short-term rates, a phenomenon known as the inverted yield curve. Such a downward sloping yield curve portends a contraction in the national economy in the next six to nine months while an upward sloping yield curve suggests economic growth. The accompanying chart provides yield curves for three periods: September 2000 (seven months before the economy peaked), March 2001 (the official start of the recession, according to NBER), and March 2003. The steep positive yield curve for March 2003 indicates a continuation of the current economic expansion.




While employment and business investment continued to remain a drag on the national economy, consumer spending remained resilient. Consumer spending increased 3.1 percent in 2002, which followed a 2.5 percent increase during 2001 and 4.4 percent during 2000. The consumer has been the sustainable engine for current economic growth.

The economic drivers behind such resilience have been the growth in real personal income and wealth. Such growth is attributed to low inflation, which increases the real purchasing power of the consumer, and low interest rates, which lower the cost of consumer durables and the cost of home financing. While corporate equities are in a bear market, home equity has steadily increased such that the value of household investment in real estate has overtaken corporate equities and mutual funds for the first time since 1995. With the increase in personal income and wealth attributed to the growth in home equity, consumer spending rather than corporate investment remains the economic driver.




It is against the national economic backdrop that the economic performance of the Washington metropolitan area and Montgomery County is analyzed. According to the Center for Regional Analysis (CRA), George Mason University, the region's economy is different but not immune to national and international forces. What distinguishes the region from other local economies is the presence of the federal government which directly accounts for more than 30 percent of the area's economy.

The region's economy underperformed during 2002. The indicator of current economic activity decreased in January for the second consecutive month. While such declines were attributed to the unusually cold winter, the index declined 15.4 percent since its peak in November 2000. The Center for Regional Analysis estimated that three of the four components of the index declined – wage and salary employment, consumer confidence, and volume of domestic airline passengers – decreased over the year ending January 2002. However, the fourth component, consumer spending on nondurable or staple goods, increased 7.7 percent over the same period.

Consumer confidence reflects economic weakness in the region. Because of weak confidence, consumer spending on durable goods remained flat. However, business confidence may be rebounding with payroll employment growing 1.6 percent, the help wanted index up 21.4 percent, and housing permits increasing an impressive 14.0 percent.

Inflation as measured by the consumer price index for the Washington-Baltimore consolidated metropolitan statistical area remained subdued in 2002 increasing 2.4 percent for all items and 2.9 percent for all items less food and energy. However, while prices overall remained subdued, gasoline prices in the Central Atlantic Region increased dramatically since November 2002. Prices for regular grade reached an average high of $1.69 per gallon during week in which the war in Iraq began.

While the regional economy experienced sub-par performance during 2002 and early 2003, Montgomery County's economy experienced mixed results. Highlights of the County's economic performance include:

- Payroll employment increased by approximately 2,300 during the first three quarters of 2002 compared to the same period in 2001.

- The County's unemployment rate increased to 2.8 percent in 2002. This is the third consecutive yearly increase. The unemployment rate was 2.5 percent for January 2003.

- Retail sales as measured by sales tax receipts increased a meager 0.9 percent in 2002 and declined 3.2 percent in February 2003 from the same period last year.

- Housing sales increased a modest 3.1 percent during 2002 and experienced the same increase during the first quarter of 2003. Average home prices increased 16.5 percent in 2002 and 14.6 percent for the first two months of 2003.

- The number of building permits, both residential and nonresidential, declined in 2002 after two consecutive years of growth.

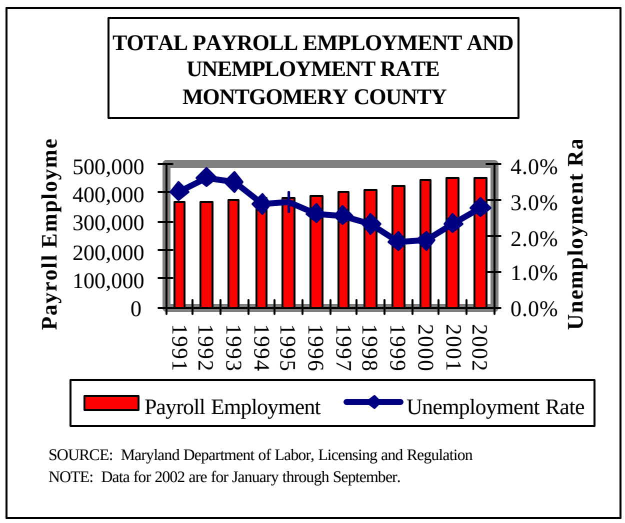
- Office vacancy rate (Class A property) reached a seven-year high in 2002 and was essentially unchanged in the first quarter of 2003.

## MONTGOMERY COUNTY ECONOMIC INDICATORS

### *Employment Situation*

Total payroll employment increased by 2,300 jobs during the first three quarters of 2002, the latest date for which data are available. The increase in total payroll employment of 0.5 percent for the first nine months of 2002 was the smallest increase since the 0.2 percent gain during the first nine months of 1992. Both periods immediately follow a national recession.

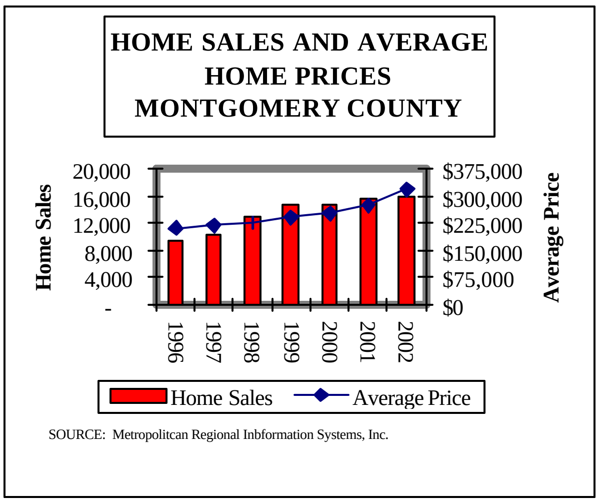
While this growth represents a modest 0.5 percent increase over the previous period, most of the gain was in the public sector compared to the private sector. While the public sector gained 2,400 jobs during the first nine months of 2002, the total private sector lost 100 jobs. The largest loss occurred in the manufacturing industry (-1,467), information technology (-838), and the professional and business services sector (-741). Those combined losses of approximately 3,000 jobs were partially offset by the gain of 2,500 jobs in the education and health services sector.



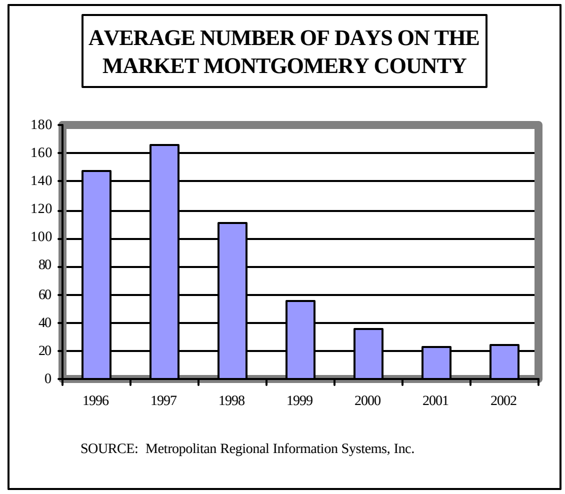

The unemployment rate for the County has steadily increased from a low of 1.8 percent in 1999 to 2.8 percent in 2002. The unemployment rate in January of this year stood at 2.5 percent, which was slightly higher than the rate in December (2.3%) but below the rate in January 2002 (2.9%). Although the unemployment rate in the County has steadily increased over the past three years, it remains significantly below the State (4.4%) and the region (3.7%) for 2002.

### *Residential Real Estate*

Home sales in the County increased modestly in 2002. The increase of 3.1 percent follows a gain of 0.4 percent in 2000 and 5.2 percent in 2001. The three years combined represent an average growth rate of 2.9 percent which was significantly lower than the average rate of 16.4 percent during the 1997-99 years. While the growth in sales remained significantly lower compared to the late 1990s, housing prices accelerated 8.4 percent in 2001 and 16.5 percent in 2002.



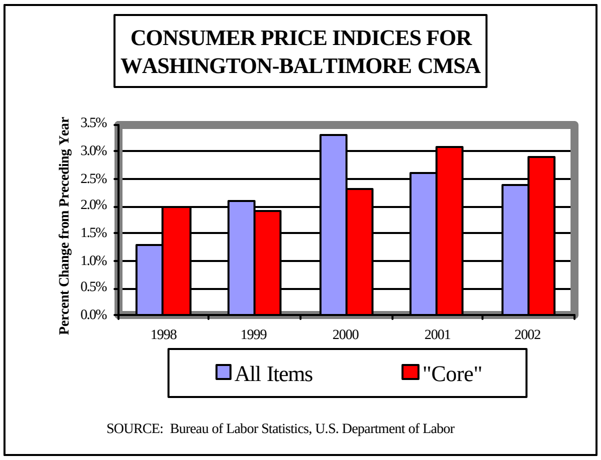

While such price increases may suggest a housing bubble in the County similar to the stock market bubble of the late 1990s, the data do not support such an assertion. First, unlike corporate equities and mutual funds, housing provides a service, i.e. family shelter, as well as an investment. Second, demand for housing unlike the demand for securities is a function or combination of economic and demographic factors. The rapid increase in prices in the County is due to a growing demand attributed to an increase in the number of households, declining mortgage interest rates, and growing real personal incomes in the County, compared to a smaller increase in the supply of housing. An indication of rising demand is the average number of days a home is on the market in the County, which decreased from approximately 160 days in 1997 to less than 30 days in 2002.



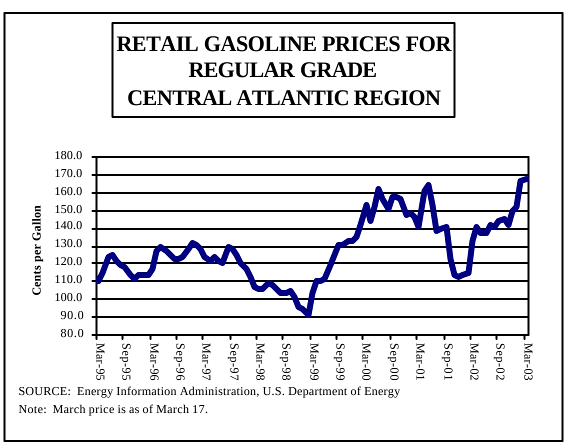

The modest acceleration in home sales and the continuation of accelerating average prices occurred during the first two months of 2003. Sales increased 5.9 percent during January and February compared to the first two months of 2002, which was above the average rate of 2.9 percent during the 2000-2002 years, while home prices continued their dramatic gain increasing 14.6 percent compared to the first two months of 2002. The increase in home sales is especially noteworthy given the unusually harsh winter season.

### *Consumer Prices*

While oil prices increased dramatically during the latter months of 2002 and into the first two months of 2003, overall inflation for the County increased slightly in January to 3.3 percent over January 2002. Most of the increase is attributed to rising gasoline prices in the region. The “core” rate of inflation, i.e. the overall rate less food and energy, remained subdued in January at 2.8 percent. The “core” inflation rate has remained relatively constant over the past two years.

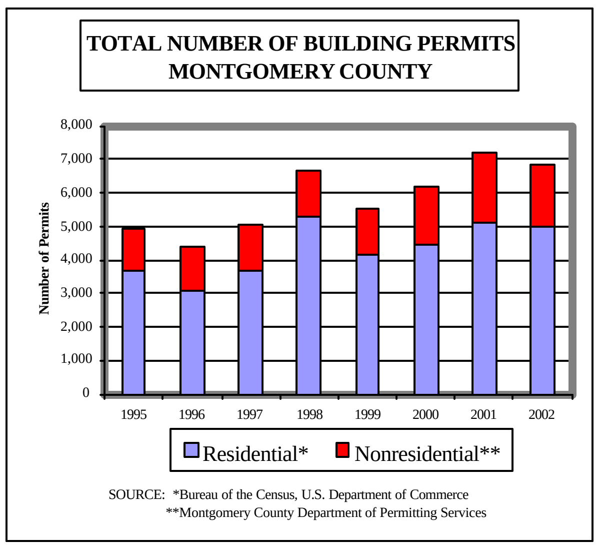



As discussed in the Economic Overview, a $10 per barrel rise in the price of oil adds about 1 percent to the rate of inflation. A direct result of the increase is in the price of gasoline. Since November 2002, the price of regular grade, not including special blends, increased 25½ cents (18.0%) and reflects the increase in crude oil (27.7%) over the same period. Gasoline prices in February and March reached their highest levels ever overtaking the previous high in May 2001. If prices of oil and gasoline would remain at their historic high levels, then overall inflation in the County would reach 4.0 percent by the end of the year.



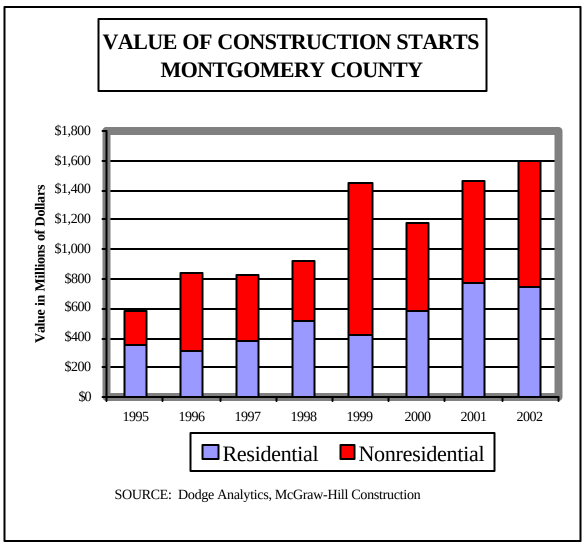

### *Construction*

Residential and nonresidential construction in the County during the first two months of 2003 provides two different contrasts compared to 2002. Residential building permits increased a dramatic 28.9 percent over January and 69.1 percent compared to February 2002. The increase in early 2003 follows a 1.5 percent decline during 2002. However, the number of nonresidential building permits continues to decline. Permits issued for nonresidential construction decreased 26.2 percent in February over January and 7.0 percent compared to February 2002. The drop in building permits for nonresidential construction follows an 11.6 percent drop in 2002.




Residential and nonresidential construction in the County declined dramatically during the first two months of 2003. While the decline is mainly attributed to an unusually harsh winter, especially its effect on residential construction, the decline in nonresidential construction is also attributed to the dramatic rise in office vacancy rates since 2001.

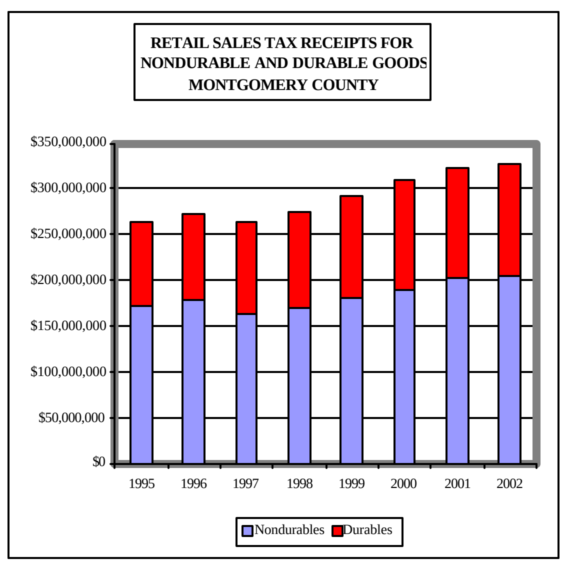
The number of residential construction projects was down 44.8 percent in February compared to a 23.7 percent increase in January. Nonresidential construction projects were down 11.5 percent compared to a 27.8 percent decrease in January. For the first two months of this year, total construction was down 53.2 percent compared to the first two months of 2002. Such declines follow a three-year boom in which the total value of construction reached an all-time high of $1.6 billion.




The dramatic growth in nonresidential construction over the past two years has added approximately 4.3 million ft$^2$ to an estimated 3.0 million ft$^2$ of vacant office space. Since 2000, when the vacancy rate hit a recent low of 2.5 percent in December of that year, the rate accelerated to 8.7 percent one year later, and to 9.9 percent two years later. Such a dramatic change in vacancy rates can have a significant effect on nonresidential construction in the near term. In response to the rapid rise in office vacancy, mostly attributed to the slowdown in the County's economic activity, nonresidential construction has begun to decrease in order to reduce such excess capacity. Based on office property data for the month of March 2003, the vacancy rate appears to have peaked.

***Retail Sales***

Retail sales in the County for the month of February 2003 declined 3.2 percent compared to the 5.2 percent decline experienced throughout the State. The sales data are based on sales tax receipts, and while the sharp drop in sales during February can be attributed to the winter storm over the Presidents' Day holiday, the decline may be a continuation of the weak spending pattern of Montgomery County residents. The decline in sales of 1.6 percent for the first two months of 2003 follows a weak growth in retail sales of 0.9 percent 2002. While the sales of durable goods increased 1.0 percent in January and February, sales of durable goods declined 6.2 percent. Since December 2000, the sales of durable goods in the County have remained flat.



| SELECTED ECONOMIC INDICATORS | Reporting Period | Current Period | Prior Year's Period | Year To-Date 2003 | Year To-Date 2002 | 2002 |
|---|---|---|---|---|---|---|
| **Leading Indicators** | | | | | | |
| National | February | -0.4% | | -0.5% | | -0.1% |
| Washington MSA | January | 0.9% | | 0.5% | | -0.5% |
| **Coincident Indicators** | | | | | | |
| National | February | 0.0% | | 0.9% | | 0.8% |
| Washington MSA | January | -1.9% | | 0.1% | | -1.4% |
| **Consumer Confidence Index** | | | | | | |
| National | March | -3.5% | | -32.1% | | -14.7% |
| South Atlantic Region | March | -10.8% | | -27.3% | | -9.6% |
| **Consumer Price Index** | | | | | | |
| All Items | | | | | | |
| National | February | 3.0% | | 2.8% | | 1.6% |
| Washington - Baltimore CMSA | January | 3.3% | | 3.3% | | 2.4% |
| Core CPI | | | | | | |
| National | February | 1.7% | | 1.8% | | 2.4% |
| Washington - Baltimore CMSA | January | 2.8% | | 2.8% | | 2.9% |
| **Retail Trade** | | | | | | |
| National (sales - not adjusted) | February | 2.6% | | 4.2% | | 3.3% |
| Maryland (tax) | January | 1.3% | | 1.3% | | 1.6% |
| Montgomery County (tax) | January | 0.0% | | 0.0% | | 0.9% |
| **Employment** | | | | | | |
| National (Household Data - not adjusted) | February | 136,433,000 | 135,443,000 | 136,170,000 | 134,810,000 | 136,485,000 |
| - Percent Change | | 0.7% | | 1.0% | | -0.3% |
| Washington PMSA (at place) | January | 2,786,600 | 2,743,700 | 2,786,600 | 2,743,700 | 2,799,500 |
| - Percent Change | | 1.6% | | 1.6% | | 0.3% |
| Montgomery County (resident) | January | 493,514 | 480,527 | 493,514 | 480,527 | 489,673 |
| - Percent Change | | 2.7% | | 2.7% | | 2.5% |
| Montgomery County (payroll)** | September ('02) | 450,152 | 449,512 | 450,272 | 447,890 | 449,833 |
| - Percent Change | | 0.1% | | 0.5% | | 0.5% |
| **Unemployment** | | | | | | |
| National (not adjusted) | February | 6.4% | 6.1% | 6.5% | 6.2% | 5.8% |
| Maryland | January | 4.5% | 4.9% | 4.5% | 4.9% | 4.4% |
| Washington PMSA | January | 3.5% | 3.9% | 3.5% | 3.9% | 3.7% |
| Montgomery County | January | 2.5% | 2.9% | 2.5% | 2.9% | 2.8% |
| **Construction** | | | | | | |
| Project Cost - Montgomery County | | | | | | |
| Total ($ thousand) | February | $121,780 | $149,785 | $179,858 | $255,850 | $1,595,801 |
| - Percent Change | | -18.7% | | -29.7% | | 9.5% |
| Residential ($ thousand) | February | $24,590 | $31,218 | $69,570 | $75,738 | $744,066 |
| - Percent Change | | -21.2% | | -8.1% | | -4.2% |
| Non-Residential ($ thousand) | February | $97,190 | $118,567 | $110,288 | $180,112 | $851,735 |
| - Percent Change | | -18.0% | | -38.8% | | 25.0% |
| Building Permits (Residential) | | | | | | |
| National | February | 124,159 | 120,964 | 246,226 | 237,108 | 1,728,556 |
| - Percent Change | | 2.6% | | 3.8% | | 5.6% |
| Maryland | February | 1,675 | 1,988 | 3,803 | 4,249 | 29,213 |
| - Percent Change | | -15.7% | | -10.5% | | 0.5% |
| Montgomery County | February | 482 | 285 | 856 | 563 | 5,013 |
| - Percent Change | | 69.1% | | 52.0% | | -1.5% |
| Building Permits (Non-Residential) | | | | | | |
| Montgomery County | February | 107 | 115 | 252 | 274 | 1,858 |
| - Percent Change | | -7.0% | | -8.0% | | -11.6% |
| **Real Estate** | | | | | | |
| National | | | | | | |
| Sales | February | 5,840,000 | 5,770,000 | 5,970,000 | 5,870,000 | 5,566,000 |
| - Percent Change | | 1.2% | | 1.7% | | 5.1% |
| Median Price | January | $160,400 | $150,300 | $160,900 | $149,900 | $158,300 |
| - Percent Change | | 6.7% | | 7.3% | | 7.1% |
| Montgomery County | | | | | | |
| Sales | February | 931 | 879 | 1,884 | 1,788 | 16,030 |
| - Percent Change | | 5.9% | | 5.4% | | 3.1% |
| Average Price | February | $320,183 | $279,353 | $327,032 | $285,946 | $320,418 |
| - Percent Change | | 14.6% | | 14.4% | | 16.5% |
| Median Price | February | $260,000 | $222,000 | $260,000 | $222,500 | $255,275 |
| - Percent Change | | 17.1% | | 16.9% | | 18.7% |

**NOTE: **Data for *Year-To-Date* columns five and six are 2002 and 2001, respectively. Data in last column are 2001.**

# METROPOLITAN AREA OFFICE MARKET

### Office Vacancy Rate by Jurisdiction and Class, 03/03

| *Jurisdiction* | Class A | Class B | Class C | Total |
|---|---|---|---|---|
| Loudon | 15.9% | 19.3% | 14.4% | 16.8% |
| Fairfax | 16.1% | 11.7% | 8.7% | 14.8% |
| Frederick | 4.9% | 16.7% | 9.4% | 9.5% |
| Alexandria/Arlington | 9.3% | 10.7% | 5.2% | 9.2% |
| ***Montgomery*** | ***10.1%*** | ***8.3%*** | ***12.6%*** | ***9.7%*** |
| District of Columbia | 6.7% | 5.3% | 8.1% | 6.4% |
| Prince George's | 10.5% | 10.4% | 9.2% | 10.2% |
| *Metropolitan Area* | 11.2% | 8.8% | 8.7% | 10.1% |

### Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

| *Jurisdiction* | Class A | Class B | Class C | Total |
|---|---|---|---|---|
| Loudon | 904,876 | 507,572 | 59,928 | 1,472,376 |
| Fairfax | 10,855,208 | 2,762,458 | 231,645 | 13,849,311 |
| Frederick | 101,463 | 217,996 | 32,088 | 351,547 |
| Alexandria/Arlington | 2,199,319 | 1,703,852 | 355,379 | 4,258,550 |
| ***Montgomery*** | ***3,202,839*** | ***1,700,607*** | ***825,988*** | ***5,729,434*** |
| District of Columbia | 3,942,668 | 2,169,641 | 1,014,078 | 7,126,387 |
| Prince George's | 993,456 | 569,488 | 352,129 | 1,915,073 |
| *Metropolitan Area* | 22,199,829 | 9,631,614 | 2,871,235 | 34,702,678 |

### Office Space Inventory by Jurisdiction and Class (sq.ft.)

| *Jurisdiction* | Class A | Class B | Class C | Total |
|---|---|---|---|---|
| Loudon | 5,697,021 | 2,629,313 | 414,970 | 8,741,304 |
| Fairfax | 67,503,497 | 23,660,831 | 2,648,327 | 93,812,655 |
| Frederick | 2,073,049 | 1,302,884 | 339,912 | 3,715,845 |
| Alexandria/Arlington | 23,634,438 | 15,935,960 | 6,865,438 | 46,435,836 |
| ***Montgomery*** | ***31,820,957*** | ***20,420,165*** | ***6,574,566*** | ***58,815,688*** |
| District of Columbia | 58,809,091 | 40,589,760 | 12,461,296 | 111,860,147 |
| Prince George's | 9,475,892 | 5,500,823 | 3,826,291 | 18,803,006 |
| *Metropolitan Area* | 199,013,945 | 110,039,736 | 33,130,800 | 342,184,481 |

### Share of Office Space Inventory by Jurisdiction and Class

| *Jurisdiction* | Class A | Class B | Class C | Total |
|---|---|---|---|---|
| Loudon | 65.2% | 30.1% | 4.7% | 100.0% |
| Fairfax | 72.0% | 25.2% | 2.8% | 100.0% |
| Frederick | 55.8% | 35.1% | 9.1% | 100.0% |
| Alexandria/Arlington | 50.9% | 34.3% | 14.8% | 100.0% |
| ***Montgomery*** | ***54.1%*** | ***34.7%*** | ***11.2%*** | ***100.0%*** |
| District of Columbia | 52.6% | 36.3% | 11.1% | 100.0% |
| Prince George's | 50.4% | 29.3% | 20.3% | 100.0% |
| *Metropolitan Area* | 58.2% | 32.2% | 9.7% | 100.0% |

Note: Office Space inventory includes leasable and owner-occupied space.
Totals exclude non-classified space.
Vacant means "direct vacant" and does not include sublease space.

Source: Montgomery County Department of Planning, Research and Technology Center
Data compiled from Realty Information Group commercial space data file, 03/18/02